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Attached are APS Energy Services' comments to questions posed by Chairman Mundell, Commissioner Irvin and Commissioner Spitzer in the above referenced dockets.

Based on our experiences as an energy services provider in California and Arizona, we believe that we have a unique perspective to contribute and appreciate the opportunity to do so.

I can be reached at 602-744-5045 with any comments or questions.

Thank you,

Vicki Sandler

Vicki Sandler

Arizona Corporation Commission
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APS ENERGY SERVICES COMMENTS

I. INTRODUCTION

APS Energy Services respectfully submits its comments to some of the Commissioners questions where we believe we can offer a unique contribution from the perspective of an electric energy service provider (ESP) who has actually delivered competitive electricity to direct access customers in the Arizona service territories of Salt River Project (SRP), Arizona Public Service (APS) and Tucson Electric Power (TEP), as well as in Sacramento Municipal Utility District (SMUD), San Diego Gas & Electric (SDG&E), Pacific Gas & Electric (PG&E) and Southern California Edison (SCE) territories in California. We have also explored and are considering retail service in the Nevada and Texas markets.

There are two main ways for customers to reduce energy costs, by paying less or by using less. APS Energy Services offers both solutions and believe APS Energy Services is uniquely capable of providing competitive electric service and energy efficiency solutions. We ran a load reduction program last summer in the APS territory and participated in the California RTO's (CAISO) demand reduction program. We also provide real time metering and information services to assist customers in better understanding their usage and in controlling it to optimize energy consumption and minimize energy cost. We provide district cooling services, such as to the Bank One Ballpark and other downtown Phoenix businesses.

We have survived and thrived in a very volatile changing marketplace where many of our competitors have not. We believe we offer sustainable solutions to our business customers that would not otherwise exist if it were not for the onset of a competitive retail commodity market, despite its slow start. We also believe we have brought innovation and superior customer service to our customers along with a better understanding of their usage of energy as compared to the way power is purchased in the wholesale electric market.

II. BACKGROUND

APS Energy Services' predecessor began serving retail end use customers in Sacramento under the SMUD direct access program. SMUD is similar in its authority and structure to SRP. We bought power from market hubs, such as COB, PV, or from wholesalers internal to the load zone of NP15 in Northern California, and delivered to the SMUD control area across the western US transmission grid. After a year of serving our pioneer customers there, we exited SMUD's market because SMUD did not make the market rule changes needed to integrate with the inception of the CAISO. SMUD continued to alter and interpret the program rules to its advantage and there was no independent forum for us to seek relief to make the rules more level and fair. This created an uncertain and unpredictable market in which our company was put at risk.

We simultaneously began serving well-known commercial and industrial customers in California at the opening of the investor-owned utilities market in April 1998. We served many customers there until the collapse of the Power Exchange (PX) in January 2001. At that time, this index was critical to the workings of the retail competitive market. The PX was the most liquid exchange for buying hourly, varied amounts of power, which is needed to serve retail customers, unlike many wholesale transactions that are done in 25mW or greater blocks of 100% load factor power. Power for retail customers has to be shaped to meet their varying power needs over the course of a day. We returned our "hard fought for" retail customers to the Utility Distribution Companies (UDCs) in January 2001, but resumed service around July 2001 to new customers because the wholesale market price conditions again changed, but this time to our favor. Despite what the media writes about California, having been a market participant whose profits and losses were on the line there, many aspects of the market worked. Much interference by regulators and Legislators in that market distorted what ultimately may have worked itself out and become a workably competitive market. APS Energy Services has re-entered the California market and is serving customers there, but regulatory certainty is still a problem.

In Arizona, we were again the first to serve direct access customers. We began serving in SRP's territory in 1999, APS' in 2000 and TEP's during the first quarter of 2001. The APS and SRP shopping credit (the amount the customer was charged in the bundled tariff for generation that was subtracted from the direct access tariff, resulting in the "shopping credit" for the customer to use to buy power from a competitor) was fixed at 3.5-4cents/kwh. Early in 1999, the wholesale market prices, (including the adjustment to the price for a retail customer taking less than 100% load factor) were just lower than this credit. However, by the end of 2000, wholesale market prices hit 18cents/kwh. All our APS and SRP customers were returned because power could no longer be bought for less than the shopping credit and due to the SRP return policy discussed below. In TEP's territory, the credit floated with market changes, so we were able to buy power and offset the cost with the market generation credit, until TEP arbitrarily changed its interpretation of the market generation credit component of its rate settlement agreement. We made demand that the appropriate amount be credited, but faced with significant dollars at risk; this action forced us to return our TEP customers to TEP while we resolved the dispute. The AECC negotiated with TEP regarding its market generation credit and the outcome was recently filed with the ACC in Docket No. E-01933A-98-0471. This Docket was recently consolidated with this generic docket. Until resolved, we will not resume direct access service in the TEP territory.

APS Energy Services comments center around a response to the last question posed by Chairman Mundell on 2/7/02 regarding our VISION of what a competitive market in Arizona should look like. There are a few overriding market structure issues that if handled appropriately, will support a workably competitive retail market.

III. APS Energy Services' VISION of a competitive retail market:

First, a workably competitive wholesale market must exist for retail customers to have direct access to. Second, meaningful delivery to retail customers on a basis equal to other network users, such as the UDC, must exist. Third, the business rules of the state need to facilitate direct access.

A. Competitive wholesale market

Meaningful retail competition will exist only if we have direct access to a workably competitive wholesale market that is liquid and transparent. This is one where there are many buyers and sellers of varied products, including hourly energy sales at competitive prices. Capacity is paid for through market pricing which incents the building of enough generation supply to meet demand. We do not need a Power Exchange like California had, but we do need sellers of hourly products.

B. Meaningful transmission and distribution access

ESP contracted-for power has equal access to the transmission system to serve retail customers. Without meaningful delivery, the availability of new generation will be insufficient to make the market work. While there will still be volatility in the commodity market, as is the case with all commodity markets, there needs to be more stability in the regulatory climate. This will enable competitors to make investments needed to become the very participants the markets need to ensure competitiveness. The AZISA serves an interim purpose until the WestConnect or other RTO is implemented to ensure that ESP's can fairly get generation reliably into control areas to serve retail customers. Equal transmission access is provided by a neutral, independently governed Board in a statewide or larger RTO, that includes public power playing by the same rules. Disputes are resolved quickly by an independent RTO. To give equal opportunity to new entrants, the system should be redispatched, if necessary, to get ESP-contracted for power into load centers just as the incumbents do. All network users, including the UDC and its customers would have comparable access and pay their pro-rata share of such costs. More specifics on transmission access are set forth below.

C. Core versus non-core customers

Sophisticated customers ("non core") have a choice of their energy supplier. Smaller, less sophisticated customers ("core ") need to be protected by the Commission. Their aggregator, the incumbent UDC, buys for them. Core customers are protected from market volatility and ensured reliability by their regulated aggregator, the incumbent UDC serving them. The core customers have a choice of multiple rate options including a "renewable rate," an "adjustable market rate" or a "fixed long term rate," or if they desire choice, direct access. However, it is not profitable for ESPs to provide competitive electric services to the mass market at the present time. We had a business plan to do so, but the economies of scale needed to support the acquisition cost and administrative back end costs of servicing and billing these customers requires a potential market size of 10 – 50 million customers, not 5 million. Even if an offer of say, $10/mo discount coupled with Internet service is made, little residential customer interest has existed. Because there is not enough consistency among states, nor enough states, with open access to all customers, aggregation of adequate numbers of residential customers does not exist to support this market opportunity. We will monitor New Power's success in Texas, however.

The non core customers have the motivation, assuming electric costs are significant to their cost of operation, to shop and are sophisticated enough to do so. They hire consultants if needed, or their purchasing department procures power like other competitively bought inputs. Non core customers will be able to customize their purchases with their needs and operating characteristics, as we have done and are doing with our customers in California.

D. Regulatory certainty

Regulators will need to let the market work and not invoke unnecessary protectionism for those players who do not need it and who need certainty that their risk to reward decisions are based on factors that will not suddenly be changed to their detriment. Regulatory CERTAINTY is needed to ensure competitors will invest in serving new customers.

E. Business rules that facilitate direct access

Regarding business rules or policies, the UDCs' bundled service rates for the returning non-core customers should not be punitive, as this will disincent a customer from ever leaving. SRP's policies are a prime example of that. SRP implemented changes to its competitive policies. APS Energy Services and others made comments on October 21, 2001 to the SRP Board, a copy of which is attached. Since 2000, returning direct access customers are to be placed on a market-indexed rate, while other new customers are placed on standard offer tariffs. This is another reason that we returned our SRP customers in 2000. Customers desired to return to standard offer tariffs before such a policy was implemented. No cost rationale was provided for this policy or for such discriminatory treatment. None of our suggestions were adopted by the SRP Board.

APS Energy Services also suggests that UDCs design rates for the non-core customers that better replicate the cost of on-peak power in the wholesale market, which is usually twice as much as off-peak. A separate, unbundled distribution charge should exist, rather than a shopping credit that is fixed or floats under a cap. Core customers should have various standard offer rate choices, like Oregon, or default provider of last resort rates for the higher risk customers, like Texas. Existing rate structures do not factor in the risk premiums to serve certain customers, have too many subsidies, and do not reflect the true cost to serve based on the customers' characteristics.

The ACC should enforce its existing rule against long term multi-year special contracts by the UDCs. SRP offers significant discounts to customers that sign up for 3-4years. These reductions in revenue will be paid for by other customers, in effect. See comments of APS Energy Services to SRP Board, attached. TEP also offers special deals to select customers. Instead, these customers should be able to work with competitive providers and not receive a discount paid for by other customers.

In our vision of what the retail competitive market should look like, the PUC does not regulate the contracts or procurement process of the "non core" customers, it just ensures the ESPs meet certain good business standards when doing business in the state.

The ACC Code of Conduct should protect only against affiliate ESPs from gaining advantage in a commodity sale over another ESP in its home UDC territory. Restrictions beyond that are not necessary and may deprive business customers from the integrated type of services APS Energy Services offers. This could limit the conservation and demand side improvements that can be achieved through real time metering, for example. APS Energy Services must work with the local UDC to accomplish this and the Code may limit this ability with APS.

Other business rules that are needed to facilitate retail competition include an expedited, arbitrated ACC procedure for dealing with tariff or rule interpretations. Most times, the conflict is not over a rule, but the administration by the UDC of it.

Without a quick determination, competitors are at a disadvantage and customers may not get switched timely.

Metering and billing services may be provided by the ESP or by the UDC under fairly priced competitive tariffs. The economies of scale that the UDC has regarding these services are hard for a competitor to overcome, and the UDCs providing them may be the only way to foster competition. The rule prohibiting the UDC from providing competitive metering and billing services for ESPs should be eliminated.

Uniform processes should govern all DASR and related functions to switch and serve retail customers-- like a common ATM. Imagine if you had to carry 50 different ATM cards to access an ATM because SCE owned the one in Glendale, APS owned the one in Tempe, and PG&E owned the one in Phoenix. This is the situation now in each UDC territory with regard to the administrative cost and complexity we face when trying to switch customers.

In summary, the key market structure requirements to support a workably competitive wholesale and retail market are:

A. Competitive, liquid and transparent wholesale market needed for meaningful direct access by retail customer
B. AZISA or alternative independent RTO must assure meaningful delivery
C. Non core customer's direct access contracts are not regulated by the ACC
D. Business rules that facilitate retail competition include:
    - Real time pricing with flexible installation of meters
    - Expedited complaint rules for tariff interpretation
        - All players must be subjected to the same rules.
    - Regulatory certainty needed for investment in competitive business
    - No UDC long-term contracts that foreclose competitive contracts
    - Code applies to commodity not non-commodity services
    - Competitive billing and metering can be offered by UDC or ESP

<u>IV. Specific comments to items raised by other Commissioners' questions follow:</u>

1/30/02 Chairman Mundell

The ACC Rules and existing Commission authority is more than adequate to ensure transactions or dealings with affiliates do not harm customers or other ESPs. The Code may be overly broad in that energy efficiency work should be allowed to be provided by an ESP affiliate to its sister UDC.

1/22/02 Commissioner Spitzer

There are no disincentives in the competitive market to the purchase, development and use of renewables other than basic economics. While we have had customers who have wanted to buy renewables, their ultimate decision was based on price. When generation is sold in the standard offer business tariff for roughly 3.5 -5cents/kwh, and solar is at 30 cents/kwh and available only 1/3 the time, no customer will pay six times as much for an inferior service. However, at California prices, combined cycles that are cleaner than single cycle turbines could be competitive at 10 cents/kwh. APS Energy Services supports the subsidization of renewables to advance its commercial development.

1/14 & 2/7/02 Chairman Mundell

Barriers to entry clearly exist. Competition needs some fostering to put competitors in a position to compete with the incumbent, especially to ensure meaningful transmission and distribution access. A new entrant needs access to the load. It will need to firm its procured generation with ancillary services from either an RTO or control area operator under its OATT. An ESP must have access to transmission pursuant to the interim protocols of the AZISA rather than delivering its energy at multiple delivery points under the Allocated Retail Network Transmission (ARNT) method.

ARNT is completely impractical, as we learned when serving in SRP's territory and became the motivation for the interim exception to the ARNT method filed under the AZISA. When serving a small load, one cannot buy 500kw at Westwing, Kyrene and Pinnacle Peak and contract for power in a way to set new delivery points the next day if the incumbent provider determines the flows on its system have changed. We cannot compete with the incumbent's price of power in this situation; nor are there multiple buyers and sellers at the points if we were to buy power there. Only the incumbents or one or two other parties may own generation at these "non-hub" points of delivery and they are not motivated to sell to a competitor. We received price quotes way above the liquid trading hubs when we attempted to do this to comply with the ARNT methodology.
The solution is the interim treatment provided for under the AZISA and requested to be continued in its recent FERC filing, Docket No. ER02-348-000, 2/13/02.

APS Energy Services comment also answers the first question in the 2/7/02 Chairman Mundell letter re: the AZISA v. the UDC OATTS. While modifications to the UDC OATTs may be an alternative to the AZISA, this alone would not be sufficient, as Chairman Mundell suggests in item one of his 2/7/02 questions. Without the impetus of the AZISA and ACC order requiring that requisite access be put in place to facilitate direct access, we would not have come this far. An example can be taken from our SRP experience. SRP refused to join the AZISA despite what are modest expenses. (It would cost a few hundred thousand if SRP were a member.) When we served in their territory, we bought power in the load center because access was too difficult. The merchant group and the reliability group both charged us for reserves. We appealed, but the process required that we do so before the same decision-makers who ruled against us. The outcome is entirely predictable - we lost. The need for an independent RTO arbitrator cannot be overstated.

The reason the AZISA has not been used, is that the market conditions changed such that there was no opportunity to compete as an ESP by buying at wholesale prices that were higher than fixed standard offer retail prices. It was not because of any problem with the AZISA. A change to the UDC's OATTs only, would not provide independent dispute resolution for obtaining access. It is in the interpretation of the FERC protocols where the barriers occur. Delay is costly when competitive players are trying to complete real deals with real risks on the line and customers are waiting to be served. Because there is no RTO, there is no neutral body to administer the OATT. That is why the AZISA is needed until WestConnect is operational and equal retail transmission access is provided for. It is a minor cost at this stage to continue to provide the direct access option for customers.

Another example of the effectiveness of the AZISA is our experience in Nevada. AB661 provides that customers who procure power from new resources may leave the incumbent UDC. The Bill does not specify how access to the end use customer occurs. The FERC filed OATTS do not have any protocols addressing service beyond the transmission level. We have not succeeded in resolving this. Without a state impetus to specify and encourage this, the new entrants are at an extreme disadvantage.

Additional barriers are created primarily in tariff interpretation, as mentioned, although in a few instances the rule itself needs modification. The rules on billing should permit competitive providers to provide bills at the time and in the format desired by non-core customers. R14-2-210 and R14-2-1612 (N) constrain ESPs from meeting the accounting needs of large customers and add unnecessary overhead to consensual billing arrangements. The metering requirements of R14-2-1612 (k) prevent utilities from providing meter services to interval-data recorders (IDR) meters. This also prevents customers from retaining ownership of IDR meters if they return to utility service. In our experience, this requirement even caused a UDC to remove a customer owned direct access IDR meter upon return and install an exact duplicate at the customer expense. The original install was at the customer expense for the customer to continue to receive real time meter information. This example has been worked through, but it was not without cost and delay, which could have been resolved better through an expedited ACC administrative process. The customer should be able to have installed an IDR meter type that the UDC can read and maintain without being a direct access customer. Real time meters information is critical to know how to better use and conserve energy.

Finally, the Process Standardization Working Group (PSWG) is a good start to such a proactive administrative process. This positive development is where the Commission has brought UDC and competitive ESPs together to work on implementation of the Rules. The Utilities Division of ACC has recently approved the Validating, Estimating, and Editing (VEE) Rules and Procedures as agree upon by the PSWG group. Other Guides on electronic transfer of data, DASR Handbook were previously accepted. We strongly support continuation of the PSWG group's efforts to complete other critical implementation issues related to the metering service provider and meter-reading service provider's handbooks. In addition, we need to add the quick, administrative review process for implementation of tariff disputes.

Thank you for your consideration of our comments in this critical stage of development of a competitive retail market in Arizona.

APS Energy Services Comments to the SRP Board Regarding Management's Proposed Adjustments to Standard Price Plans
October 31, 2001

Introduction

In well over two years, no competition has occurred in Salt River Project's (SRP) service territory, with the exception of a short period in 1999 when APS Energy Services actually managed to serve three customers, despite significant barriers to doing so. Certain provisions of Management's Proposal will keep the door locked to choice by businesses in SRP's territory. APS Energy Services brings our actual experience from California and Arizona to bear in our recommendations to improve Management's Proposal. Our recommendations, for the Board's consideration, will facilitate a viable competitive market, while balancing legitimate interests of SRP. Our specific comments follow.

First Amended Code of Conduct Adopted dated January 8, 2001

On the surface Management's proposal to further unbundle customer service charges is heading in the right direction, with the exception of the call center. It appears that the First Amended Code of Conduct, adopted by the SRP Board early this year, provided for the SRP call center to become a competitive function and that, with appropriate safeguards in place, the call center could support both the competitive and non-competitive functions of SRP. From discussions with Management it appears that when the call center receives a call from a customer for a non-competitive service they are free to refer to or offer a SRP competitive service, rather than referring them to competitive suppliers. This discriminates in favor of SRP.

If the SRP Board is to ensure adherence to its own Code, then it needs to require that specific safeguards are in place, such that customers are not directed to SRP employees engaged in the sale of competitive services. The only way to ensure compliance with the Code is to require that the non-competitive function of SRP have an independent call center. Therefore, we recommend that the SRP Board amend the Code of Conduct and require Management to adjust the unbundling of the customer service function to put the call center within the non-competitive function.

Management's Proposal to Extend the Full Electric Service Rider (FESR)

Management's proposal to extend the existing Full Electric Service Requirements (FESR) agreements beyond their current December 31, 2001 expiration date is merely a customer retention program and is not consistent with the spirit of HB 2663 or the Arizona Corporation Commission (ACC) competition rules. It is a form of rate discrimination because it is a selectively applied discount. There are currently 560MW of SRP customer load on this rider, and the extended discount option would allow these customers to increase their discount to as much as 115% of the current discount for 4 more years. This rider violates traditional utility principles of cost of service rate making. The extension of this discount program continues to promote discrimination among SRP's existing FESR and its non-FESR customers.

SRP's ability to provide for discounts should mirror the ACC Competition Rules that apply to regulated utilities. Specifically, R14-2-1606.C.6 provides:

> "After January 2, 2001, tariffs for Standard Offer Service shall not include any special discounts or contracts with terms, or any tariff which prevents the customer from accessing a competitive option, other than time-of-use rates, interruptible rates, or self-generation deferral rates."

The reason for this provision in the ACC Competition Rules is to llow a level playing field for competition. An incumbent utility company should not be able to unfairly compete using special discounts "subsidized" by the remaining customers.

<u>Management's Proposal to Reintroduce a Fuel and Purchased Power Adjustment</u>

Management proposes to reintroduce a Fuel and Purchased Power Adjustment Mechanism to be applicable to all Standard Electric Price Plans. The only issue with the proposal is that it does not treat customers fairly because the fuel adjuster can only increase base fuel costs and not reduce them. Historically, fuel adjusters have been designed to decrease the base fuel cost as well as to increase it. Management states that by not allowing the cost to go negative it will be an incentive to contain costs. It actually is an incentive to over-collect fuel costs from customers. Perhaps this could be a marketing opportunity for energy service providers if SRP's other rules were reasonable, but since they are not, this seems unfair.
We recommend that the SRP Board allow for the fuel adjuster to go negative to fairly allocate the both risk and reward to customers.

<u>Management's Proposal to Change the Monthly Energy Index Rider</u>

Management's proposal will change the basis for the monthly Energy Index Rider energy charge for customers whose annual usage is greater than 100,000kWh who wish to return to standard offer service after procuring service from an energy service provider. The monthly energy charge was based on the final settlement prices of the Palo Verde electricity futures contract as traded on the Nymex, but is now proposed to be based on the weighted average prices of Palo Verde and West Wing from the Dow Palo Verde Index. Management's proposal is unfair to any of these future direct access customers and is anti-competitive because West Wing annually sells at about a $4 premium to Palo Verde. This change will increase the market price index used in the formula and will probably make the calculation more volatile. It is a penalty for selecting choice because any "new" SRP customer with an annual consumption of more than 1000,000kWh is not required to go on this Monthly Energy Index Rider. The cost to serve a new 1MW load is not different than the cost to serve a returning 1MW load. Returning customers should not be treated differently than customers new to the SRP territory. Additionally, it appears that this rate is at the discretion of SRP to apply, which further makes it discriminatory.

We urge the Board to adopt a reasonable alternative rather than one designed to scare customers from considering direct access in the first place. A more reasonable alternative would be similar to the provision approved by the ACC for Arizona Public Service Company which allows customers, upon reasonable notice, to return to the same standard offer rates charged to new customers, except for customers over 3MW who can be required to give the utility 1 year's advance before returning.

Continuation of the Collection of the Competitive Transition Charge

The SRP Settlement specifically provided for an adjustment to the CTC to be effective on 1/1/02 if market prices prevailing in the year 2000 are above the prices that were assumed in the stranded cost calculation in 1998. Management's proposal seeks to continue the current Competitive Transition Charge (CTC) until SRP collects its total stranded costs of $795 million or June 1, 2004, whichever comes first. Management's recommendation is based upon an August 30th Market Price Review Meeting that 1) was not properly noticed to stakeholders, such as ESPs; and 2) did not really provide an opportunity for presentations from stakeholders or customers. It appears from a copy of the presentation that Management does not believe that they can make an adequate prediction of market prices going forward for the next two years. There was no more certainty in 1998 than there is today on the prediction of market prices. There are current forward market prices publicly available, and Management should revise the stranded cost calculation and update the CTC.

To live up to the spirit of the 1998 Settlement we believe that Management should conduct a more in-depth review of market prices in conjunction with stakeholders and customers. Additionally, the appropriateness of the continued inclusion of accelerated depreciation on Palo Verde and Coronado of $120 Million per year should be revisited.

Therefore, we recommend that the SRP Board direct Management to conduct a collaborative review of market prices with stakeholders and customers to discuss and agree on forward market prices for the next 2 and ½ years.

In summary, APS Energy Services recommends Management's Proposal be revised in the following ways to provide a viable chance for customer choice:

- Put the call center within the non-competitive customer service function to ensure adherence to the Code of Conduct
- Remove the extension of FESR discounts that discriminate among customers
- Allow the Fuel and Purchased Power Adjustment Mechanism to decrease as well as increase
- Treat customers under 3MW who wish to return to standard office service the same as any new customers, such that customers over 3MW may return to standard offer service after having been served by an ESP, but may be required to give reasonable notice prior to return to SRP.